



DEPARTMENT OF THE AIR FORCE
HEADQUARTERS AIR FORCE CIVIL ENGINEER SUPPORT A



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10 April 2006

Lieutenant Colonel Karen S. White
Chief, Utility Litigation Team
139 Barnes Drive Ste 1
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Docket Control Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

Re: Docket No. E-01345A-06-0009

Dear Sir/Ma'am

Enclosed please an original and fourteen copies of the Federal Executive Agencies' Post Hearing Brief. I've also enclosed a self-addressed, stamped envelope for return of one of the copies after you've stamped it.

Thank you for your assistance in this matter.

Sincerely,

KAREN S. WHITE, Lt Col, USAF
Chief, Utility Litigation Team

Attach: FEA Post Hearing Brief
+ 14 copies

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1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2
3 **COMMISSIONERS**

4 JEFF HATCH-MILLER, Chairman
5 WILLIAM A. MUNDELL
6 MARC SPITZER
7 MIKE GLEASON
8 KRISTIN K. MAYES
9

10 IN THE MATTER OF THE APPLICATION
11 OF ARIZONA PUBLIC SERVICE COMPANY
12 FOR AN EMERGENCY INTERIM RATE
13 INCREASE AND FOR AN INTERIM
14 AMENDMENT TO DECISION NO. 67744
15

DOCKET NO. E-01345A-06-0009

**FEDERAL EXECUTIVE
AGENCIES' POST HEARING
BRIEF**

16
17 **I. BACKGROUND**
18

19 On January 6, 2006, Arizona Public Service ("APS" or "company") filed an application
20 in the subject case, seeking an interim rate increase of \$299 million in additional electric
21 revenues, to be effective April 1, 2006 and subject to refund pending the Commission's
22 final decision in Docket No. E-01345A-05-0816. Arizona Public Service subsequently
23 revised the amount of the rate increase request to \$232 million to account for changes in
24 the fuel-related expenses assuming February 28, 2006 prices. (*See Ewen Rebuttal*
25 *Testimony, APS Exhibit 14, page 2, line 14*)
26

27 In the application for interim rates, APS asked the Commission to approve an interim
28 base fuel cost of \$0.031904 per kWh (*See Application, page 1, line 19*), which amount
29 the Company subsequently modified to \$0.029419 per kWh (*See Rumolo Rebuttal*
30 *Testimony, APS Exhibit 20, page 3, line 13*). This amounts to an increase of \$0.008676
31 per kWh over the base fuel rate approved by the Commission in the last rate case,
32 Decision No. 67744. (*Id.*)
33

34 APS further requested the Commission amend Decision 67744, also on an interim basis,
35 to remove the \$776.2 million "cap" on total fuel and purchased power costs recoverable
36 in rates.

1 On February 2, 2006, the Commission issued Decision No. 68437, which allowed APS to
2 continue to defer fuel and purchased power costs in excess of the \$776.2 million “cap”
3 referenced in Decision No. 67744 until the issue was further examined in this docket.
4

5 APS cites recent negative actions taken by bond rating agencies Standard & Poor’s
6 (“S&P”), Moody’s, and Fitch, and the threat of additional downgrading action by these
7 agencies as the basis for the interim rate increase. (See Brandt Rebuttal Testimony, APS
8 Exhibit 3, page 3, lines 8-12)
9

10 On December 21, 2005, S&P lowered APS to a Business Profile “6” and a bond rating of
11 BBB-. (See Brandt Rebuttal Testimony, APS Exhibit 3, Attachment DEB- 7) These two
12 actions combined to create the situation, namely the company’s position one “rung”
13 above “below investment grade,” or “junk” status, which the company claims is sufficient
14 to create an “emergency.” Such an “emergency,” the company maintains, meets the
15 criteria for interim rate relief. (See Brandt Rebuttal Testimony, APS Exhibit 3, page 2,
16 lines 12-22; Wheeler Rebuttal Testimony, APS Exhibit 1, page 6, lines 10 – 25, page 7,
17 lines 1-3)
18

19 Phelps Dodge Mining Company and Arizonans for Electric Choice & Competition
20 (AECC) filed direct testimony proposing an alternate methodology for calculating and
21 collecting additional revenue. (See Higgins Direct Testimony, AECC Exhibit 1). In his
22 prefiled direct testimony, Mr Higgins calculates that an increase of \$126 million,
23 implemented on May 1, 2006, would be sufficient to avoid the threatened downgrade by
24 the bond rating agencies. (*Id* at page 8, line 14). During the hearing, Mr Higgins
25 adjusted the amount of revenue he believed would be sufficient to a range of between \$87
26 and \$97 million, to account for the reduced fuel prices cited by the company in the
27 revised request. However, in response to information presented by the company during
28 the hearing, AECC filed exhibit AECC-7, to return the recommended level of relief
29 necessary to achieve an FFO/Debt ratio of 18% to \$126 million (\$116 million when the
30 amount is adjusted for expected decreased debt amounts). In addition to the difference in
31 the dollar amount Mr Higgins recommended as appropriate relief, another significant

1 difference between Mr Higgins' proposal and the company's proposal is in how the
2 interim relief would be collected from customers. Instead of a per kWh basis, Mr
3 Higgins proposes to apply an equal percentage increase on all customer classes. (Higgins
4 Direct Testimony, AECC Exhibit 1, page 14, lines 8-10) AECC exhibit 7 shows the
5 percentage amount necessary to achieve the required revenue amount as 7.7%, applied to
6 the "pre Power Supply Adjustor" bill. (See AECC Exhibit 7, page 2, line 39).

7 An equally significant difference between Mr Higgins' proposal and the company's
8 proposal is the fact that Mr Higgins' proposal would not reset the base fuel rate. Instead,
9 the revenue collected under his proposed surcharge would be applied as a credit against
10 the PSA tracking account. (See Higgins Direct Testimony, AECC Exhibit 1, page 13, at
11 lines 10-12).

12
13 Mr Higgins' proposal would allow the company to improve their Funds from Operation
14 to Debt ("FFO/Debt") ratio from the current level of 14.8% to 18.0%. (Higgins Direct
15 Testimony, AECC Exhibit 1, page 10, Table KCH -2; AECC Exhibit 7, page 1, line 19).

16
17 In addition to Mr Higgins' proposal, Staff Witness Ralph Smith proposed an alternative
18 method to collect under-recovered fuel and purchase power costs. In this proposal, APS
19 would be authorized to file quarterly PSA surcharge requests to amortize under- or over-
20 recoveries. (See Smith Direct Testimony, Staff Exhibit 2, page 31, lines 4-7). Staff's
21 proposal would allow APS to recover under-recovered balances before the 2007 reset of
22 the PSA adjustor, and would involve an expedited process to address any such surcharge
23 requests. (*Id* at lines 9-21).

24
25 APS witness Steven Wheeler proposed an alteration to Staff's proposed surcharges that
26 he believed would improve the efficacy of such a surcharge in ameliorating the concerns
27 of the bond rating agencies about the certainty of recovery of deferred fuel balances.
28 Specifically, Mr Wheeler recommends that surcharge amounts detailed in Staff's
29 proposal be treated similarly to changes in the PSA rate, and become effective
30 automatically thirty days after filing unless Staff's review uncovers some "extraordinary

1 circumstance requiring Commission action.” (See Wheeler Rebuttal Testimony, APS
2 Exhibit 1, page 11, lines 8-10).

3
4 During the Hearing, parties were asked to consider adjustments to the PSA “bandwidth”
5 to expand the bandwidth by various levels and thereby accelerate collections of under-
6 recovered balances in the PSA Tracking Account. APS and Staff witnesses prepared
7 analyses of expansions of the PSA bandwidth to 5 mills, 6 mills, 7 mills, 8 mills, 9 mills
8 and 10 mills. (See APS Exhibit 18G-18L; Staff Exhibits 7 – 10).

9
10 **II. COMMISSION AUTHORITY TO GRANT AN INTERIM RATE**

11
12 **A. When does the Commission have authority to grant an interim rate?**

13
14 Arizona’s case law is clear that the Commission has the authority to grant an interim rate
15 increase. (See, e.g., *Naco Water Company, LLC*, Decision No. 67984, citing Op. Atty.
16 Gen 71-17; *RUCO v. ACC and Rio Verde Utilities, Inc.*, 199 Ariz. 588; 20 P.3d 1169
17 (2001); *Scates v. ACC*, 118 Ariz. 531; 578 P.2d 612 (1978)). That same body of case law
18 sets out the findings that the Commission should make when determining that interim
19 rates are appropriate. *Id.* Specifically, the Commission should use interim rates in those
20 “limited circumstance where an emergency exists, a bond has been posted guaranteeing a
21 refund to the utility’s subscribers if any payments are made in excess of the rates
22 eventually determined by the Commission and where a final determination of just and
23 reasonable rates is to be made by the Commission after it values a utility’s property.”
24 *Scates* at 535.

25
26 **B. How should the Commission determine if there is an “emergency”?**

27
28 **The Commission should follow the criteria set out in Arizona Attorney General**
29 **Opinion 71-17.**

30 According to past Commission decisions and Op. Atty. Gen. No. 71-17, “interim or
31 emergency rates are proper when either all or any one of the following conditions occur:
32 when sudden changes brings hardship to a Company; when the Company is insolvent; or

1 when the condition of the Company is such that its ability to maintain service pending a
2 formal rate determination is in serious doubt.” *Naco Water Co.*, *supra*, at *4.

3
4 APS does not believe that these conditions are required by Op. Atty. Gen. No 71-17,
5 rather, the circumstances identified in the opinion are “only examples of when emergency
6 relief is appropriate and not an all-inclusive list of “criteria.”” (See Wheeler Rebuttal
7 Testimony, APS Exhibit 1, page 6, lines 13-15.) Further, APS cites language in the
8 opinion which the company sets out as an additional situation under which interim rates
9 would be appropriate. Specifically, APS cites language from the opinion which states,
10 “...the inability of the Commission to grant permanent relief within a reasonable time
11 would be grounds for granting emergency relief.” (See *Id.*, lines 15-16)

12
13 The company’s position that Op. Atty. Gen. No. 71-17 is merely instructive about the
14 situations where the Commission may grant interim relief is unpersuasive. Commission
15 decisions subsequent to the Attorney General’s opinion do not treat the criteria as mere
16 examples of when interim rates are appropriate. Furthermore, the Commission has not
17 treated these criteria as “examples” of when interim rates are appropriate, but rather has
18 used the criteria to evaluate whether emergency situations existed prior to granting
19 interim rates. Therefore, it is appropriate to evaluate whether interim rates are
20 appropriate under the framework set out in the Attorney General’s opinion and
21 subsequent case law and Commission opinions. That is, in order for the Commission to
22 grant interim rates, the Commission should find that an emergency exists, a bond has
23 been posted guaranteeing a refund to the utility’s subscribers if any payments are made in
24 excess of the rates eventually determined by the Commission and where a final
25 determination of just and reasonable rates is to be made by the Commission after it values
26 a utility’s property.

27
28 **C. In the absence of an “emergency,” does Commission have authority to grant an**
29 **interim rate?**

30 Arizona Revised Statutes specifically contemplate the situation where the Commission
31 would need to revise or amend a previous decision. Arizona Revised Statutes, Section

1 40-252 provides that “[t]he commission may at any time, upon notice to the corporation
2 affected, and after opportunity to be heard as upon a complaint, rescind, alter or amend
3 any order or decision made by it.” The facts in this proceeding fit squarely in the
4 situation contemplated by A.R.S. § 40-252, in that the Commission is asked to amend
5 Decision No. 67744 to allow for additional revenues to be collected to ameliorate large
6 deferred under-collected fuel costs, and also to “lift” the \$776.2 million “cap” on fuel and
7 purchased power costs.

8
9 Clearly, APS has had ample opportunity to be heard on the issue of whether the
10 Commission should amend Decision No. 67744 (or Decision No. 68437, as it might
11 apply to the “cap” amount), and therefore, the requirements of § 40-252 are satisfied.

12
13 **III. HAS ARIZONA PUBLIC SERVICE COMPANY ESTABLISHED THAT AN**
14 **“EMERGENCY” EXISTS SUFFICIENT TO AUTHORIZE COMMISSION**
15 **APPROVAL OF INTERIM RATES?**

16 **A. Likelihood/impact of bond rating agency action**

17 **1. APS asserts it is facing a financial “emergency” due to the threat of**
18 **downgrading of APS Bonds from BBB- to below investment grade (“junk”) status.**
19 Although APS contends that the criteria listed in Op. Atty. Gen. 71-17 are not
20 “requirements” for a finding of an emergency, APS contends that APS satisfies “three of
21 the four circumstances explicitly listed by the Attorney General in his 1971 Opinion.”
22 (See Wheeler Rebuttal Testimony, APS Exhibit 1, page 7, lines 13-15). APS asserts that
23 the “escalation of unrecovered fuel and purchased power costs this year” combined with
24 the threatened downgrade to “junk” status “adversely affects the Company’s ability to
25 provide adequate service in the long run.” (See *Id.*, page 7, at lines 7-11). Furthermore,
26 Mr Wheeler contends that the “Commission cannot act quickly enough on the general
27 rate case to affect 2006,” thus satisfying the other prong of the “test” to determine
28 whether interim rate relief is appropriate. (See *Id.*, at lines 12-13).

29
30 In his testimony, Donald Brandt addresses the various reports issued by the credit
31 reporting agencies subsequent to the downgrading action taken by Standard & Poor’s on

1 December 21, 2005. (See Brandt Rebuttal Testimony, APS Exhibit 3, Attachments DEB-
2 7 through DEB-10) Taken together, Mr Brandt contends, these reports send a clear
3 message that “rate relief sufficient to cover APS’ projected unrecovered fuel and
4 purchased power costs overshadows all other factors in determining APS’ credit ratings.”
5 (See Brandt Rebuttal Testimony, APS Exhibit 3, page 21, lines 6-8) Mr Brandt points to
6 comments made by Anne Selting, of Standard and Poor’s, on January 26, 2006 and again
7 on February 15, 2006 that refer to a requirement of “sustained regulatory support that
8 adequately addresses building deferrals.” (See Brandt Rebuttal Testimony, APS Exhibit
9 3, DEB-8, page 2, DEB-17, page 3) Mr Brandt believes that these statements clearly set
10 out that “a further downgrade might be warranted if the Commission does not address the
11 significant cash flow volatility and working capital requirements caused by high and
12 rising natural gas commodity costs.” (See Brandt Rebuttal Testimony, APS Exhibit 3,
13 page 16, lines 8-11).

14
15 Mr Brandt uses one of the financial ratios reported on by the rating agencies to illustrate
16 the current financial condition of APS. This ratio, the Funds from Operations to Debt
17 ratio (“FFO/Debt”), is a ratio that financial analysts use to measure “the sufficiency of a
18 company’s cash flow to service both debt components – interest and debt principal – over
19 time,” and it “carries the most weight with credit rating agencies in determining ratings.”
20 (See Brandt Rebuttal Testimony, APS Exhibit 3, page 11, line 15 – 19). Mr Brandt
21 testified that at a Business Position “6,” which APS currently holds, the rating agencies
22 consider an appropriate FFO/Debt ratio to be in the range of 18 – 28 %. (Brandt Rebuttal
23 Testimony, APS Exhibit 3, page 11, line 3-7). Currently, APS’ FFO/Debt projected ratio
24 for 2006 is 15.1%, which Mr Brandt describes as “significantly below the lower limit of
25 the acceptable range.” (See Brandt Rebuttal Testimony, APS Exhibit 3, page 16, line 19)

26
27 **2. Rating agencies may take downgrading action regardless of action by the**
28 **Commission.**

29 Although APS puts a lot of emphasis on the comments of the rating agencies that related
30 to FFO/Debt ratios and Business Position, the company does not put as much emphasis
31 on additional comments by the rating agencies that signal other significant concerns that

1 are separate from the financial performance of APS. Specifically, at least two of the
2 rating agencies expressed concerns about ongoing “operational” issues of APS. (*See, e.g.*
3 APS Exhibit 3, DEB-10 (Fitch comments on 30 Jan 2006); DEB-7 (S&P comments on 21
4 Dec 2005); DEB-17 (S&P comments on 15 Feb 2006)). On December 21, 2005, in the
5 same report that downgraded APS bond ratings to BBB- and changed the company’s
6 Business Position to “6,” S & P specifically mentions the “performance of the Palo Verde
7 nuclear units in 2005” as an “additional factor contributing to PWCC’s weakened
8 business position.” That same report goes on to state that “the stable outlook is also
9 dependent on improved 2006 performance at Palo Verde.” (APS Exhibit 3, DEB-7,
10 pages 2 and 4 respectively). In February 2006, S&P again commented on the potential
11 for negative action related to Palo Verde performance, when they stated that “negative
12 ratings actions could result if timely regulatory support is not sustained or if market
13 forces or operational issues lead to significant increases in the expected 2006 deferral
14 level. (APS Exhibit 3, DEB-17, page 3 (emphasis added)). Clearly these reports note
15 the rating agencies’ continuing concern with financial and operational issues facing APS,
16 and suggest that even if regulatory support were received, negative rating action could
17 still take place in the event of unanticipated operational issues

18
19 **B. Does APS’ current financial situation meet the criteria of “emergency” set out in**
20 **Arizona Attorney General Opinion 71-17?**

21
22 **1. Is there a sudden change that brings hardship to the company?**

23 Although there is certainly evidence that natural gas prices have risen since the last rate
24 case was finalized in Decision No. 67744, APS offered no evidence that a “sudden
25 condition” caused the growing deferrals of fuel and purchased power costs. The heavy
26 reliance on natural gas fired-generation is not a new or “sudden” condition. The rising
27 prices of natural gas, and the related increase in purchased power costs, although
28 exacerbated by hurricanes in 2005, were likewise known conditions to APS.
29 Furthermore, APS knew that it might have uncollected fuel and purchased power
30 balances, as this was expressly contemplated and addressed with the PSA mechanism
31 approved in Decision No. 67744.

1

2 **2. Is the company insolvent?**

3 Mr Brandt testified that APS is not insolvent, nor is the company facing a “liquidity
4 crisis” which he defined as the inability of the company to “pay its bills.” (*See* Brandt
5 Rebuttal Testimony, APS Exhibit 3, page 7, lines 10 – 15)

6

7 **3. Is the condition of the company such that its ability to maintain service
8 pending a formal rate determination is in serious doubt?**

9 Mr Wheeler opined that the current FFO/Debt ratio and the threatened further downgrade
10 of APS’ bond rating with the rating agencies combine to create an “emergency” situation
11 which jeopardizes APS ability to provide “adequate service in the long run.” (emphasis
12 added) (*See* Wheeler Rebuttal Testimony, APS Exhibit 1, page 7-11). Additionally, Mr
13 Brandt testified that he believes that the repercussions of a bond rating downgrade would
14 impair APS’s ability to raise capital in the same manner as APS has been raising capital,
15 and that such changes would incur significant costs for ratepayers. (*See* Brandt Rebuttal
16 Testimony, APS Exhibit 3, page 24, lines 18). However, the standard is not whether
17 service would be provided under current conditions, but whether the company would be
18 unable to provide service to its customers due to the emergency situation. Clearly, APS
19 will be able to provide service to its customers, albeit potentially with additional
20 financing costs if further downgrading action takes place.

21

22 **C. FEA Position—APS has not met the criteria which would authorize interim
23 rates, however, modification of Decision No. 67744 is appropriate in this situation
24 and should be granted by the Commission.**

25 Although APS has not met the criteria listed in Op. Atty. Gen. 71-17, namely that they
26 have faced a sudden hardship, are insolvent, or are unable to continue to provide service
27 until the completion of the pending general rate case, APS demonstrated that the current
28 adjustor and surcharge mechanisms are not fully recovering fuel and purchased power
29 costs in a timely manner. (*See, e.g.* APS Exhibit 18 for tracking account balances of
30 deferred costs) Therefore, it is appropriate to modify such adjustors to more fully

1 recover costs. The Commission has authority to take such action under ARS 40-252, and
2 has met the statutory requirements of that provision.

3
4 **IV. WHAT MODIFICATION OF CURRENT ADJUSTOR MECHANISMS**
5 **WOULD BE APPROPRIATE AND HOW SHOULD THE RELIEF BE**
6 **GRANTED?**

7 **A. Amounts proposed by various proposals/discussion of proposal impacts.**

8 **1. APS Proposal--\$232 million granted as interim rate increase.**

9 APS urges the Commission to grant a \$232 million increase, and to change the base fuel
10 rate to \$0.029419 per kWh. This would equal an increase of \$0.08676 per kWh for all
11 customer classes. FEA Exhibit 1 shows the impact on Luke Air Force Base of the
12 company's proposal as approximately \$72,453/mo during the summer and \$68,072/mo
13 during the winter. Mr Higgins testified that the impact on customers in the E-34
14 customer class would be greater than 20% depending on the customer's individual load
15 factor. (See Higgins Direct Testimony, AECC Exhibit 1, page 15, Table KCH-4)

16
17 Mr Brandt testified that the FFO/Debt ratio that would be achieved by this proposal
18 (including the pending 2005 surcharge amounts) is 20.6% (See APS Exhibit 9 "APS
19 Proposed Surcharges and Interim Increase" data point). Such a ratio is well within the
20 "acceptable" range for a Business Profile "6" company.

21
22 **2. Staff Proposal – quarterly surcharge to amortize deferred fuel costs**
23 **remaining in PSA tracking account after PSA 4 mill bandwidth adjustor.**

24 Staff witness Ralph Smith introduced a proposal whereby APS would be permitted to file
25 quarterly (vice annually) for surcharges to recover remaining deferred fuel and purchased
26 power costs that were not recovered by the 4 mill PSA. (See Smith Direct Testimony,
27 Staff Exhibit 2, page 31, lines 4 – 7). The Staff proposal would allow APS to file a
28 surcharge request to recover an estimated balance in the PSA tracking account of \$33
29 million on June 30, 2006, and that such a surcharge would be effective August 1, 2006.
30 The second surcharge application, under Staff's proposal, would be \$144 million and
31 would be effective November 1, 2006. (See Staff Exhibit 7, page 1). The Staff proposal

1 does not negate the need for the pending surcharge amounts in Docket E-01345A-06-
2 0063 of \$15 million and \$44 million for under-recovered 2005 fuel and purchased power
3 costs. Basically, the staff's proposal would allow APS to accelerate surcharge requests to
4 recover deferred costs more than currently allowed (once a year, after the PSA reset).
5 APS calculated the FFO/Debt ratio that would be achieved under this proposal as 16.6%
6 (See APS Exhibit 9 "Staff Proposal" data point).

7
8 APS proposed a "modification" to the Staff's proposal. (See Wheeler Rebuttal
9 Testimony, APS Exhibit 1, page 11, lines 8-11). Mr Wheeler's modification to the
10 surcharge process would make the surcharges "automatic" after 30 days unless the Staff
11 finds some "extraordinary circumstances requiring Commission action." This procedure
12 would be similar to how changes in the PSA adjustor rate are treated. (*Id*) With this
13 modification, the FFO/Debt ratio of the Staff surcharge proposal would increase to
14 17.0%. (See APS Exhibit 9, "Staff Proposal As Modified by APS" data point)

15
16 Both the Staff proposal and the Staff proposal as modified would result in FFO/ Debt
17 ratios that are below the "expected" range of 18-28%.

18
19 **3. AECC Proposal -- \$126 million granted through 7.7% surcharge applied**
20 **to customers' "pre-PSA" bills.**

21 Mr Higgins, on behalf of AECC and Phelps-Dodge, proposed an alternate method of
22 relief for APS' under-recovered fuel and purchased power costs. He recommended
23 granting approximately \$126 million in relief, to be recovered through an equal
24 percentage surcharge applied to each customer's "pre-PSA" bill. Mr Higgins' proposal
25 would achieve an FFO/Debt ratio of 18%, which is within the "expected" range of a
26 Business Profile "6" company, although admittedly at the lower end of that range. (See
27 Higgins Direct Testimony, AECC Exhibit 1, page 6, lines 1-2). If the full amount
28 recommended by Mr Higgins were granted, the "percentage increase" for each
29 customer's bill would be 7.7% (See AECC Exhibit 7, page 2, line 39). If APS' debt
30 amounts decreased due to reduced market prices for fuel and purchased power, a revenue
31 increase of \$126 million would produce an FFO/Debt ratio of 18.2% (See AECC Exhibit

1 7, page 3, line 50). AECC Exhibit 7 shows an alternate amount that would achieve a
2 similar FFO/Debt ratio. If APS' debt levels decrease in response to reductions in fuel and
3 purchased power costs, then the amount necessary to achieve an FFO/Debt ratio of 18%
4 would likewise decrease, to approximately \$117 million. Such a decrease would result in
5 a 7.2% increase to customer bills under the AECC proposal. (See AECC Exhibit 7, page
6 4, lines 63 and 72)

7
8 **4. Chairman Hatch-Miller Proposal – increase PSA bandwidth by various**
9 **levels.**

10 During the hearing, Chairman Hatch-Miller asked the parties to consider the impacts of
11 expanding the PSA "bandwidth" to varying degrees between the status quo of 4 mills and
12 10 mills. Both APS and Staff witnesses prepared analyses of the varying impacts. (See
13 APS Exhibit 18 G-L and Staff Exhibits 7-10). In order to get an FFO/Debt ratio near the
14 range for a Business Position "6" company, the adjustor would need to be increased to at
15 least 8 mills (See APS exhibit 19 and 19a and Staff Exhibit 8). There are differences in
16 the FFO/Debt numbers shown in these exhibits, which apparently may be at least
17 partially explained by tax effects on revenue figures used by staff witness Barbara Keene
18 and her assumption that APS' debt level would not change, even though prices of fuel
19 and purchased power are lower than when the case was originally filed. However, even
20 with the differences, both exhibits show that at least an 8 mill adjustor would be
21 necessary to get into or near the range of 18-28 % FFO/Debt. An 8 mill adjustor would
22 increase Luke AFB's bills by the same dollar impact currently shown in FEA Exhibit 1 as
23 the PSA 2-1-2006 amount (the current PSA 4 mill adjustor). Basically, an 8 mill PSA
24 amount would be double the current amount shown of \$33,404/mo in the summer and
25 \$31,384/mo in the winter.

B. The APS proposal inappropriately modifies the PSA cost-sharing mechanism ordered by the Commission in Decision No. 67744.

In Decision No. 67744, the Commission approved a cost-sharing mechanism for the Power Supply Adjustor. (Decision 67744, page 13, lines 18-19). That cost-sharing mechanism allowed customers and APS to share the costs and savings of fuel and purchased power costs, 90% and 10% respectively. (*Id.*) Fuel and purchased power costs above the level provided for in the base fuel rate are shared between customers and the company on a 90/10 basis. (*See* Higgins Direct Testimony, AECC Exhibit 1, page 12, lines 18-21).

The company's proposal would reset the base fuel rate, and would, thereby, limit the amount of costs that would flow through the PSA mechanism, because the amount of costs between the new base rate and the actual costs would be lower. In effect, APS would be avoiding the 10% cost differential between the current base energy rate of \$0.020743 per kWh and the new base energy rate of \$0.029419 per kWh, which the company would otherwise absorb under the current PSA mechanism. (*See* Higgins Direct Testimony, AECC Exhibit 1, page 13 lines 2-4).

Residential Utility Consumer Office (RUCO) witness Marylee Diaz Cortez also expressed concern with resetting the base fuel rate. In her prefiled direct testimony, Ms Diaz Cortez stated "[g]ranting an emergency interim rate increase at this juncture would substantively change the terms of the settlement agreement and Decision No. 67744." (Diaz Cortez Direct Testimony, RUCO Exhibit 5, page 9, lines 17-19). Ms Diaz Cortez points out in her Direct Testimony that approval of the emergency interim rate request as proposed by the company would "circumvent this sharing mechanism and result in 100% of the under-recovered fuel and purchased power costs being borne by ratepayers." (*Id.* at page 10, lines 2-4). She further recommends that "any revisiting of this sharing provision should take place in the pending full rate case, where it can be considered in the broader context of APS' overall rates." (*Id.* at lines 6-8).

1 **C. Any rate relief granted should preserve the cost-sharing (“90/10 sharing**
2 **provision”) mechanism of Decision No. 67744.**

3 Both Mr Higgins and Ms Diaz Cortez testified that changing the base fuel rate in this
4 proceeding would substantively change the terms of the settlement agreement that the
5 Commission approved in Decision No. 67744. During the last rate case, both parties
6 made concessions in order to arrive at a settlement, and in return for those concessions,
7 each party received something of value to that party. Specifically, APS received the
8 value of more certainty of recovery of fuel costs than would have been the case absent a
9 fuel adjustor, and other parties got assurances of cost sharing from the sharing
10 mechanism approved in Decision No. 67744. Changing the base fuel cost at this time
11 would materially change the benefit of the bargain that the parties struck in the settlement
12 that led to Decision No. 67744. The Commission’s actions in this case should preserve
13 the benefit of that bargain by adopting a mechanism for recovery of any revenue amounts
14 approved that does not change the base fuel rate.

15
16 **D. Any rate relief granted should be imposed equally on all customers through a**
17 **“percentage of bill” methodology, rather than a “per kWh” basis.**

18 **1. Higher load factor customers, such as Luke AFB and Marine Corps Air**
19 **Station Yuma, pay an uneven proportion of increases when rates imposed on a per**
20 **kWh basis.**

21 Mr Higgins testified that the impact on many industrial customers would be higher than
22 the “average” amount depicted by APS of 14%. He demonstrates how industrial
23 customers would be affected by the proposed rate increase in Table KCH-4, which shows
24 that a customer in the E-34 customer class with a load of 5000 kW/month, and a load
25 factor of 55% would be facing a 21% increase, and a customer with a load factor of 75%
26 would be facing a 23% increase. These amounts, he testified, are nearly “70 percent
27 higher than the average 14 percent average advertised by APS.” (Higgins Direct
28 Testimony, AECC Exhibit 1, page 15, lines 4-5)

1 **2. In an interim proceeding, where information about cost of service is not**
2 **available, it is equitable to spread interim rates to customer classes equally, rather**
3 **than on an uneven basis.**

4 Mr Higgins testified that it would be “inappropriate in the context of an emergency rate
5 filing – with its limited record and restricted opportunity for analysis – to levy
6 disproportionate increases on different customer groups.” (Higgins Direct Testimony,
7 AECC Exhibit 1 page 14, lines 5-8). He further opines that if an emergency increase is
8 granted, the “only appropriate rate design would be an equal percentage increase for all
9 customer groups.” (*Id* at lines 8-10) After discussing several current proceedings in
10 which state commissions have approved across the board increases for interim rates, Mr
11 Higgins notes that “absent a record to properly determine that various customer groups
12 should bear different burdens, it is the only reasonable approach to spreading an interim
13 rate increase.” (*Id* at page 17, lines 15-17) Such a record, of the differing burdens and
14 costs of service, is absent in this truncated proceeding, and therefore, the Commission can
15 not adequately assess whether industrial customers with higher load factors should bear a
16 larger percentage of the increased fuel and purchased power costs. The PSA adjustor
17 mechanism, which the Commission approved in Decision No. 67744, was the result of a
18 settlement between the various parties in the last rate proceeding, and to infer from that
19 settlement that higher load factor customers should always bear a higher percentage of
20 fuel costs, simply because they agreed to a PSA mechanism that imposes higher impacts
21 in the limited circumstance of the PSA, would be an unfair extension of that settlement.
22 Until such time as the Commission can assess the various burdens and costs associated
23 with the various customer classes in a general rate case proceeding, an equal percentage
24 approach to this interim request is the most equitable approach.

25
26 **E. FEA Position—The Commission should approve the AECC proposal of \$126**
27 **million. The amount granted should be applied as a surcharge, not as a change to**
28 **the base fuel rate, and should be equally allocated to all customer classes on a**
29 **“percentage of bill” basis of 7.7%.**

30 AECC’s proposal would have a significantly different impact on customers such as Luke
31 AFB and MCAS Yuma than any of the other proposals. APS Exhibit 22 illustrates the

1 difference between the impacts on “average” E-34 customers of the two proposals. The
2 company’s proposal would impose an additional cost (over current rates) on an average
3 E-34 customer of \$23,283/mo (in the summer). (See APS Exhibit 22, 13th page, entitled
4 “General Service Revised Emergency/Interim Request, line entitled Emergency/Interim
5 rate case/summer block). AECC’s proposal would impose an additional cost of
6 \$12,809/mo (adjusting APS Exhibit 22, 18th page, entitled “General Service AECC
7 Emergency/Interim Proposal with 5.3% Interim charge to instead reflect the 7.7%
8 increase recommended in AECC Exhibit 7)¹ The difference between these two proposals
9 is \$10,474/mo. As Mr Robinson and Mr Rumulo agreed during their testimony, the
10 amounts shown in APS Exhibit 22 are for the average customer, with an average monthly
11 usage of 2.6 million kWh. Luke AFB’s monthly usage is 2- 2.5 times larger than
12 average, so the impact of the difference would be 2- 2.5 greater than the average or
13 approximately \$21,000/mo. Since the interim rates/surcharges will be in effect until the
14 general rate case is resolved, the difference to Luke AFB alone would be at least
15 \$168,000 (21,000 x estimated 8 months until completion of permanent rate case).

16
17 Similarly, if the PSA adjustor were expanded to 8 mills, the impact on Luke AFB would
18 be \$20,595 greater than the AECC proposal. (.004 increase equal to \$33,404 (summer),
19 see FEA Exhibit 1, “PSA 2-1-2006” line). The total impact on Luke AFB of increasing
20 the PSA adjustor, instead of applying the increase as proposed by AECC, would be
21 nearly \$206,000. (20,594 x 10 months (May – Feb 07))

22 23 24 **VII. CONCLUSION AND RECOMMENDATION**

25 **A. Conclusions**

26 **1. APS has not met the criteria which would authorize interim rates,**
27 **however, modification of Decision No. 67744 is appropriate in this situation and**
28 **should be granted by the Commission.**
29

¹ To adjust this amount, I used the “typical bill amount” for E-34 customer of \$166,354 and multiplied that by 7.7%, which is the amount recommended by AECC in AECC Exhibit 7. That calculation generates a monthly increase of \$12,809.

1 2. The APS proposal inappropriately modifies the PSA cost-sharing
2 mechanism ordered by the Commission in Decision No. 67744 by changing the base
3 fuel rate in this proceeding.

4
5 3. Any rate relief granted should preserve the cost-sharing ("90/10 sharing
6 provision") mechanism of Decision No. 67744.

7
8 4. Any rate relief granted should be imposed equally on all customers
9 through a "percentage of bill" methodology, rather than a "per kWh" basis.

10
11 **B. FEA Recommendations**

12 FEA urges the Commission to approve the AECC proposal and grant APS an
13 increase amount of \$126 million, which amount should be collected as a surcharge of
14 7.7% of the "pre PSA" amount on each customer's bill.

15
16 RESPECTFULLY SUBMITTED this 10th day of April, 2006

17
18
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